

STATE OF MICHIGAN
IN THE SUPREME COURT

CITIZENS INSURANCE COMPANY,

Plaintiff/Appellant,

S.C. No. 130099

v

COA No. 262759

PRO-SEAL SERVICE GROUP, INC.,
d/b/a PRO-SEAL, INC., a Michigan
corporation,

L.C. No. 04-056953-CZ

Defendant/Appellee.

and

FLOWERVE CORPORATION, a New York corporation,
FLOWERVE MANAGEMENT COMPANY, a
Delaware corporation, SETH SHORT and
RANDY QUINCY,

Defendants,

and

PRO-SEAL SERVICE GROUP, INC.,
d/b/a PRO-SEAL, INC., a Michigan
corporation,

Counter-Plaintiff,

v

CITIZENS INSURANCE COMPANY,

Counter-Defendant.

**CITIZENS' RESPONSE TO DEFENDANT/COUNTER-PLAINTIFF/APPELLEE'S
SUPPLEMENTAL BRIEF**

SEP 21 2006

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Preliminary Statement

The argument advanced in Pro-Seal’s supplemental brief urges the Court to violate the most fundamental rules in determining whether an insurer owes a duty to defend its insured in an underlying action. An insurer owes a duty to defend its insured only if the insurance contract between them imposes that obligation. The contractual duty to defend in the Citizens CGL policy imposes a duty to defend only as to a suit that seeks, in pertinent part, “damages because of ‘personal and advertising injury’ to which this insurance applies.” If the underlying complaint does not assert a theory of recovery that seeks damages because of “personal and advertising injury” as that is described in (and not excluded by) the policy, there is no duty to defend. That is the case here.

In its supplemental brief, Pro-Seal effectively skips over the fundamental requirement of comparing the allegations of the underlying complaint with the language of the policy, and focuses instead on the secondary, albeit oft-repeated, tenets that an insurer owes a defense if the allegations of the underlying complaint “arguably” come within policy coverage, and must “look behind” the allegations of the underlying complaint to analyze whether coverage is possible. Pro-Seal misapplies these tenets to argue that Citizens owes a duty to defend based on a hypothetical set of factual allegations that quite clearly is not asserted in the Flowserve complaint, either in form or in substance. Pro-Seal seems to suggest that the duty to “look behind” the allegations of an underlying complaint requires an insurer to defend if there “arguably” are facts in existence that would trigger a defense obligation if a theory of recovery had been asserted based on those facts—even if it was not.

Because, however, it is the allegations of the underlying complaint that determine whether an insurer owes a defense obligation, not a set of facts, real or imagined, on which the

underlying complaint is *not* based, Pro-Seal's latest attempt to establish a defense obligation fails. Inasmuch as Michigan law does not require an insurer to defend its insured against allegations that, in form and in substance, do not present a theory of recovery under the insurance policy, and because the Flowserve complaint does not assert a theory of recovery that is covered under the Citizens CGL policy (or the umbrella policy)—either in form or in substance—Citizens does not owe a duty to defend.

Perhaps more importantly, Pro-Seal fails to demonstrate that a defense obligation would be triggered even if the allegations of Flowserve's complaint *had* been based on the factual scenario Pro-Seal describes. Pro-Seal claims that it used a prominent red label on products that it knew would be "on display" in "a staging area" at "the Roteq distribution center," which, according to Pro-Seal, is a place frequented by customers. According to Pro-Seal, this was "a distribution and advertising system." (Pro-Seal's Supp Brf, pp 5-6). Apart from the fact that Flowserve's theories of recovery are not based on this factual scenario (regardless of whether it is true), the scenario fails to establish coverage for three additional, independent reasons: (1) it does not involve infringement of Flowserve's trade dress or advertising idea; (2) it does not involve a Pro-Seal "advertisement" in accordance with the definition of that term in the CGL policy; and (3) even if it involved both a Pro-Seal "advertisement" and either trade dress infringement or an advertising idea, there is no suggestion of infringement of Flowserve's trade dress or use of Flowserve's advertising idea *in* a Pro-Seal "advertisement."

Finally, even if Flowserve's complaint were read to allege "[p]ersonal and advertising injury," it clearly seeks damages based solely on injury knowingly and intentionally caused. Citizens' duty to defend, as outlined in the insurance contract, requires it to defend Pro-Seal only against suits seeking damages because of personal and advertising injury to which the insurance

applies. Even if it were deemed to seek damages for personal and advertising injury as defined in the Citizens policy, Flowserve's complaint does not seek damages to which the insurance applies because it does not assert a theory of recovery to which the "with knowledge" exclusion does not apply.

A. An insurer does not owe a duty to defend if the complaint against its insured does not allege, in form or in substance, a theory of liability that is covered under the policy.

The determination whether, under Michigan law, an insurer owes a duty to defend its insured in a suit brought against the insured hinges on two documents: The insurance contract and the underlying complaint. As this Court has recognized, the duty to defend arises solely from the language of the insurance contract. *Stockdale v Jamison*, 416 Mich 217, 224; 330 NW2d 389 (1982). As the Court has also recognized, in *Protective Nat Ins Co of Omaha v City of Woodhaven*, 438 Mich 154, 159; 476 NW2d 374 (1991), "The duty of the insurer to defend the insured depends upon the allegations in the complaint of the third party in his or her action against the insured." The Court has also recently reaffirmed that insurance policies are subject to the same contract construction principles that apply to any other species of contract. *Rory v Continental Ins Co*, 473 Mich 457, 461; 503 NW2d 23 (2005). These are the fundamental legal principles for determining whether a duty to defend is owed in a given case.

Pro-Seal does not take issue with any of these principles, but focuses instead on two corollary tenets: (1) if the allegations of a third party against the policyholder even arguably come within the policy coverage, the insurer must provide a defense; and (2) the duty to defend cannot be limited by the precise language of the pleadings; the insurer has a duty to look behind the third party's allegations to analyze whether coverage is possible. *See American Bumper & MFG Co v Hartford Fire Ins Co*, 452 Mich 440, 450-452; 550 NW2d 475 (1996) (citations

omitted). These corollary tenets, though foreign to any other contract interpretation context, are found, and often repeated, in the caselaw. While they can be helpful in determining whether an insurer owes a duty to defend, it is critical that they not be employed in a way that would violate the first three principles. For example, in determining whether an underlying complaint “arguably” alleges a covered claim, a court should not give the terms of the insurance contract a strained construction that is inconsistent with its ordinary meaning. *See Henderson v State Farm Fire & Cas Co*, 460 Mich 348, 354-355; 596 NW2d 190 (1999). In purporting to “look behind” the language of the underlying complaint to determine if a covered theory is asserted in substance, a court should not hypothesize additional facts on which the theories in the complaint are not premised, and then declare based on those facts that coverage is “possible.”

As explained in greater detail below, Pro-Seal would have the corollary tenets regarding a duty to defend swallow the primary rules from which that duty derives. Specifically, under the auspices of looking “behind” the Flowserve complaint, Pro-Seal asserts a host of facts that are mentioned nowhere in the Flowserve complaint, e.g., that Pro-Seal put seals “on display sitting on a shelf in a staging area” that was frequented by customers, and placed a prominent red label on the product in the hope that the product would become widely known to customers (Pro-Seal’s Supp Brf, pp 5-6). Pro-Seal then suggests that Flowserve was really asserting a theory of recovery based on these unpled facts.

Contrary to Pro-Seal’s position, the duty to look “behind” the pleading in order to determine the substance (as opposed to the mere form) of the complaint does not mean that the insurer must assume that the theories of recovery asserted in the underlying complaint might be based on some non-alleged factual scenario, or that the underlying plaintiff intended to allege something entirely different. If that were the case, no insurer could ever properly deny a defense.

As the principle has been phrased by the Court of Appeals: “Inasmuch as the insurer must look behind the precise wording of the allegations in a third-party’s complaint against its insured to determine whether coverage is possible, so must the allegations be examined to determine the substance, as opposed to the mere form, of the complaint.” *Illinois Employers Ins Co v Dragovich*, 139 Mich App 502, 507; 362 NW2d 767 (1984). In other words, courts should not get hung up on the precise language or form of a complaint if the substance of the claims the complaint is attempting to assert triggers coverage. This exercise of looking “behind” the precise language of a complaint to understand its substance does not mean a court should hypothesize a factual scenario that is neither alleged in the underlying complaint nor necessarily foundational to the theories of recovery asserted in that complaint.¹

Decisions from other jurisdictions provide helpful articulations of this basic point. In *Friedman Professional Management Co, Inc, v Norcal Mut Ins Co*, 120 Cal App 4th 17, 34-35; 15 Cal Rptr 3d, 359 (Cal App 4 Dist 2004), the court recognized that “the universe of facts bearing on whether a claim is potentially covered . . . does not include *made up* facts, just because those facts might naturally be supposed to exist along with the known facts. An insured is not entitled to a defense just because one can imagine some additional facts which would create the potential for coverage.” In *Gunderson v Fire Ins Exchange*, 37 Cal App 4th 1106, 1114; 44 Cal Rptr 2d,

¹ Pro-Seal appears to acknowledge that it is appropriate to look “behind” the allegations of an underlying complaint only “where necessary to understand the theories of liability that are asserted.” (Pro-Seal’s Supp Brf, p 3). Flowserve’s complaint is a classic example of a comprehensive, fact-intensive, and artfully-pled complaint for which there is no need to look behind the allegations in order to understand the theories of liability being asserted. Pro-Seal’s purported look “behind” Flowserve’s complaint to understand its asserted theories is more accurately characterized as a search outside the complaint for unpled facts that would support an unasserted theory of recovery. Likewise, Pro-Seal’s suggestion that the theory of trade dress infringement “may not be artfully pled” in Flowserve’s complaint (Pro-Seal’s Supp Brf, p 9) misses the point: Flowserve’s complaint does not plead a theory of trade dress infringement, period—much less trade dress infringement in a Pro-Seal advertisement.

272 (Cal App 1 Dist 1995), the court explained, “An insured may not trigger the duty to defend by speculating about extraneous ‘facts’ regarding potential liability or ways in which the third party claimant might amend its complaint at some future date. This approach misconstrues the principle of ‘potential liability’ under an insurance policy. . . . A corollary to this rule is that the insured may not speculate about unpled third party claims to manufacture coverage.” (Emphasis in original). Other courts are in accord. *See, e.g., Pine Oak Builders, Inc v Great American Lloyds Ins Co*, __ SW3d __, 2006 WL 1892669 (Tex App–Hous (14 Dist)) (“[I]n reviewing the pleadings, we will not read facts into them or imagine factual scenarios in order to find covered claims.”); *Moscarillo v Professional Risk Management Services, Inc*, 169 Md App 137, 150; 899 A2d 956, 964 (2006) (“Unasserted causes of action that could potentially have been supported by the factual allegations or the extrinsic evidence cannot form the basis of a duty to defend . . .”). *See also Bristol West Ins Co v Whitt*, 406 F Supp 2d 771 (WD Mich, 2005) (“[U]nder Michigan law, the allegations of the underlying complaint, not the insured’s version of events, frame the insurer’s duty to defend.”)

As detailed below, regardless of what unpled facts might have existed at the time Flowserve filed its complaint, because the allegations of Flowserve’s complaint, whether viewed in their form or for any additional substance “behind” them, do not trigger coverage under the Citizens CGL policy, Citizens does not owe a duty to defend.

B. The Flowserve complaint does not allege injury arising out of infringing upon Flowserve’s trade dress in Pro-Seal’s “advertisement” or the use of Flowserve’s advertising idea in Pro-Seal’s “advertisement.”

1. Flowserve’s complaint does not allege trade dress infringement.

In its supplemental brief, Pro-Seal endeavors to “try a different approach” to the question whether the Flowserve complaint alleges trade dress infringement. (Pro-Seal’s Supp Brf, p 7).

Pro-Seal's new approach is to argue that the allegations of unfair competition in violation of Alaska's Unfair Competition Statute constitute, in substance, allegations of trade dress infringement, triggering coverage as personal and advertising injury under the definition "infringing upon another's copyright, trade dress or slogan in your 'advertisement'." Specifically, Pro-Seal argues, "The requirements of the (Alaska) statute are a codification of the doctrine of trade dress infringement. Flowserve has set out a claim for trade dress infringement as a subset of unfair competition." (Pro-Seal's Supp Brf, p 8).

Flowserve's complaint makes no mention of the Alaska statute on which Pro-Seal bases its argument, AK ST §45.50.471(b)(3). (Flowserve's Complaint is filed as Exhibit B to Citizens' application.) In fact, Flowserve's claim of unfair competition in violation of Alaska law (Count II) identifies no Alaska statute. The statute to which Pro-Seal points is taken from Alaska's Unfair Trade Practices Act. In order to establish a prima facie case of unfair or deceptive acts or practices under that act, a plaintiff must prove two elements: (1) that the defendant is engaged in trade or commerce; and (2) that in the conduct of trade or commerce, an unfair act or practice has occurred." *Odom v Fairbanks Memorial Hosp*, 999 P2d 123, 132 (Alaska, 2000). Pro-Seal assumes that the allegation of unfair competition under Alaska law is, in fact, an allegation of a violation of AK ST §45.50.471(b)(3). But there is no indication in the Flowserve complaint that that is the Alaska law at issue.

The greater flaw in this new argument, however, is in the assumption that all allegations of unfair competition in violation of Alaska state law necessarily constitute allegations of trade dress infringement. While it might be arguable that trade dress infringement is a "subset" of unfair competition, this obviously does not mean that the latter is a subset of the former, i.e., that all allegations of unfair competition necessarily encompass allegations of trade dress

infringement. The point Pro-Seal is apparently trying to make is based on a logical fallacy: That allegations of the lesser necessarily include allegations of the greater.

Even assuming Flowserve's unfair competition claim is intended to allege a violation of the Alaska statute to which Pro-Seal points, an allegation of "causing a likelihood of confusion or misunderstanding as to the source . . . of goods or services," AK ST §45.50.471(b)(3), does not set out a claim of trade dress infringement, contrary to Pro-Seal's argument. To plead a claim of trade dress infringement, one must allege that (1) the claimed trade dress is non-functional; (2) the claimed trade dress has secondary meaning; and (3) there is a likelihood of confusion between the plaintiff's goods and the defendant's. See *Yurman Design, Inc v PAJ, Inc*, 262 F3d 101, 115-16 (CA 2, 2001); *Clicks Billiards Inc v Sixshooters Inc*, 251 F3d 1252, 1258 (CA 9, 2001). A plaintiff must also offer "a precise expression of the character and scope of the claimed trade dress." *Landscape Forms, Inc v Columbia Cascade Co*, 113 F3d 373, 381 (CA 2, 1997).

Flowserve does not even allege trade dress, much less trade dress that is non-functional and has secondary meaning—much less a precise expression of the character and scope of any claimed trade dress.²

2. Flowserve's complaint does not allege "use of another's advertising idea."

In its supplemental brief, Pro-Seal asserts a new argument that is found nowhere in its 36-page response to Citizens' application for leave to appeal, that coverage is triggered under the

² Pro-Seal also states, without any reference to Flowserve's complaint, that Flowserve alleges "false advertising," and even claims it is an "absurdity" that Citizens would argue that there is no advertising alleged in a complaint "clearly based upon allegations of false advertising under the Lanham Act." (Pro-Seal's Supp Brf, p 9). Flowserve's complaint does not allege false advertising. As Citizens pointed out in its reply brief (p 7, fn 6), the Lanham Act "provides for two distinct causes of action: false designation of origin or source, known as 'product infringement,' and false description or representation, known as 'false advertising.'" *Resource Developers, Inc v Statue of Liberty-Ellis Island Found, Inc*, 926 F2d 134, 139 (CA 2, 1991). See also, *Cottrell, Ltd v Biotrol Intern, Inc*, 191 F3d 1248, 1252 (CA 10, 1999). The Flowserve Complaint alleges only the former type, false designation of origin or source.

definition “The use of another’s advertising idea in your ‘advertisement’.” Nor was this argument seriously advanced below. Pro-Seal’s failure to advance this argument previously speaks more loudly than its brief attempt to do so at this stage.

Because the phrase “advertising idea” is not defined in the Citizens CGL policy, the Court will give it its common, ordinary meaning. *Henderson, supra*. While no published decision from this Court or the Michigan Court of Appeals has defined the phrase “advertising idea” in the context of insurance coverage,³ in the recent decision *Gemini Ins Co v Andy Boyd Co*, 2006 WL 1195639 (SD Tex, 2006), the court helpfully defined this phrase as “a concept about the *manner* a product is promoted to the public.” (*Id.*, Slip Op, p 2 (emphasis in original)). This definition, which accurately captures the ordinary meaning of the phrase “advertising idea,” is not implicated by any of the allegations in Flowserve’s complaint. There is nothing in Flowserve’s complaint to suggest that Pro-Seal used a Flowserve concept about the manner in which a Flowserve product was promoted to the public. In fact, Flowserve’s complaint does not allege that Pro-Seal used any “concept” or “idea” of Flowserve’s at all. Rather, it alleges only that Pro-Seal used Flowserve’s “P-50,” “BW/IP,” “BW Seals,” and “Flowserve” marks to identify Pro-Seal’s products. (See, e.g., Flowserve Complaint, ¶ 21). And there is no allegation or suggestion in Flowserve’s complaint that these marks constitute Flowserve’s “advertising ideas.”

To the contrary, the Flowserve complaint suggests that the Flowserve name and the other identifying marks are *not* advertising ideas. In paragraph 10 of its complaint, Flowserve alleges that it has distributed flow-management process products under the “Flowserve” trademark since

³ As discussed below, the Court of Appeals did apply the phrase—in a case with facts fairly similar to those of the instant case—in the unpublished but well-reasoned opinion *Varilease Technology Group, Inc v Michigan Mut Ins Co*, 2004 WL 2913661 (Mich App) (**Exhibit 1**).

1997. It then alleges, “Process industry customers have come to associate that mark with Flowserve’s high-quality products and certified repair services. *Through Flowserve’s development and promotion of its mark* and the high quality of its products and services, Flowserve has developed tremendous goodwill in the marketplace . . .” (Flowserve Complaint, ¶ 10 (emphasis added)). This paragraph illustrates the difference between a trademark per se and an “advertising idea.” While Flowserve does allege that “Flowserve” is a trademark, it is not alleging, and there is no reason to assume, that the name “Flowserve” itself was conceived by someone as a concept about the manner in which to promote products. The manner in which Flowserve “develop[ed] and promot[ed]” that trademark or others could represent advertising ideas of Flowserve’s. But there is no suggestion in the Flowserve complaint that the manner in which Flowserve developed or promoted its products (or its marks) was used by Pro-Seal. Flowserve did not allege, for example, that it came up with the idea of putting its trademarks on its seals or boxes, and that that idea was used by Pro-Seal.

The same analysis is true of the other marks, “P-50,” BW/IP,” and “BW Seals.” There is nothing in Flowserve’s complaint to suggest, and no reason to assume, that “P-50” for example was conceived by someone as a way to promote a particular type of seal. It is far more reasonable to assume that that designation was assigned to that particular product merely as a way to identify it, with no thought toward whether that name itself would attract customers. Users of that product may have come to recognize the so-called “P-50” seal to be a desirable product, through Flowserve’s promotion of that mark or product or otherwise. But that does not mean that the selection of the arbitrary mark “P-50” was itself an “advertising idea.”

The closest that any Michigan appellate decision has come to applying the meaning of “advertising idea” in the concept of trademark infringement recognizes that trademarks and

trademark infringement claims do not necessarily implicate “advertising ideas” such that an insurer in this context owes a duty to defend. In *Varilease Technology Group, Inc v Michigan Mut Ins Co*, 2004 WL 2913661 (Mich App), which is attached hereto as **Exhibit 1**,⁴ the underlying complaint (the Unisys complaint) alleged trademark infringement against the insured in that the insured falsely represented the origin of Unisys’s diagnostics software and materials as being the insured’s original works. Unisys also alleged that the insured falsely represented to customers of Unisys that the insured was licensed by Unisys and used Unisys software and materials.

The Court of Appeals recognized that there are conflicting authorities nationally concerning whether trademark infringement may constitute “misappropriation of advertising ideas or style of doing business,” which was the policy language at issue in that case. *Varilease*, at *5. The court reasoned that the issue was not whether trademark or trade dress infringement claims as a category involve “misappropriation of advertising ideas or style of doing business.” *Id.* at *6. Rather, the issue was whether the specific allegations in the Unisys complaint alleged “misappropriation of advertising ideas or style of doing business.” The court concluded that the Unisys complaint “does not implicate any Unisys ‘advertising ideas.’” *Id.* at *6.

While *Varilease* is obviously not controlling here, Citizens respectfully submits that it is correctly decided, and on point. Whereas Flowserve’s complaint, like the Unisys complaint in

⁴ The *Varilease* decision was also filed as Exhibit L with Citizens’ Application for Leave to Appeal.

Varilease, alleges trademark infringement, it simply does not implicate any Flowserve advertising ideas.⁵

Pro-Seal's argument that the Flowserve complaint alleges use of Flowserve's advertising idea consists of the simple declaration that "trademarks and trade dress constitute an advertising idea . . ." (Flowserve's Supplemental Brief, p 18). Initially, it should be noted that this argument proves too much, for if "trade dress" is the same thing as, or is encompassed by, "advertising idea," then why would the CGL policy provide two separate definitions, one for "the use of another's advertising idea in your 'advertisement'" and another for "infringing upon another's . . . trade dress . . . in your 'advertisement'"? In order for the phrases "use of another's advertising idea" and "infringing on another's . . . trade dress" to have any distinctive meaning in the context of the CGL policy, one cannot be read to be the same thing as, or to encompass, the other.

Secondly, even if trade dress were deemed inherently to constitute an advertising idea, that is certainly not a reason to hold that all *trademarks* do so. As set forth above, even if some trademarks are properly deemed to be advertising ideas because they represent concepts about the manner in which a product is promoted, this is simply not true of all trademarks. In particular, an arbitrary name or symbol assigned to a product in order to identify it, which is not itself a concept or idea to promote that product, is not properly characterized as an advertising idea.

⁵ The distinction between a trademark per se and an "advertising idea" is also illustrated by a decision from this Court, *Salon v WM Fink & Co*, 302 Mich 65; 4 NW2d 469 (1942). In that case, the plaintiff sought to recover compensation for an advertising idea of his that was used by the defendant. The advertising idea was to utilize a sound car, equipped with a loud speaker device, at the back of which was a model pig. *Id.* at 67. The car and the loud speakers were used to broadcast the defendant's trademark and slogan. The trademark of the defendant was not itself an advertising idea; the advertising idea was the manner in which the trademark was promoted.

Pro-Seal cites no authority for the proposition that an allegation of trademark infringement necessarily constitutes an allegation of use of an “advertising idea.” Pro-Seal states only that appendices A and B to its brief in response to Citizens’ application for leave to appeal “contain numerous cases which confirm” that trademarks and trade dress constitute an advertising idea. (Pro-Seal’s Supp Brf, p 18). Pro-Seal’s failure to discuss any of those cases in its supplemental brief is telling; virtually all of them involve policy language different than the language of the Citizens CGL policy (to the extent they involve insurance disputes at all), and not one involves the application of Michigan law – except for *Poof Toy Products, Inc v United States Fidelity & Guarantee Co*, 891 F Supp 1228 (ED Mich, 1995), which Citizens distinguished in its application for leave to appeal.

Further, to the extent Pro-Seal’s position has support from cases from other jurisdictions, the cases have generally held, at most, that trademarks or trade dress *may*, but do not necessarily, constitute “advertising ideas.” For example, in *Hyman v Nationwide Mut Ins Co*, 304 F3d 1179, 1191 (CA 11, 2002), which is probably the case on which Pro-Seal most heavily relies, the court ruled that trade dress infringement may, under certain circumstances, constitute a “misappropriation of advertising ideas or style of doing business” – but that it will not always do so. The Court emphasized, “[F]or the injury to be covered under the policy, the trade dress at issue must constitute an ‘advertising idea’ or ‘style of doing business’ and it must have been ‘misappropriated.’” *Id.*

Regardless of whether a trademark can, in some instances, constitute an “advertising idea,” because Flowserve’s complaint does not allege that Pro-Seal used a Flowserve advertising idea, even if it used Flowserve’s trademarks, coverage of the allegations of Flowserve’s complaint is lacking.

3. Flowserve's complaint does not allege a Pro-Seal "advertisement."

In an attempt to establish the existence of an "advertisement" as is required in order for coverage to exist, Pro-Seal seeks to rewrite both the CGL policy (in particular, its definition of "advertisement") and the Flowserve Complaint. Because, however, the allegations of Flowserve's complaint, whether viewed on their face or for any additional substance "behind" them, do not assert a Pro-Seal "advertisement" as that term is defined in the CGL policy, the contractual duty to defend was not triggered.

To the extent its brief in response to Citizens' application for leave to appeal did not contort the meaning of the word "advertisement" to the point where it has no distinctive meaning whatsoever, Pro-Seal's supplemental brief finishes the job. Despite acknowledging that the term is explicitly defined in the CGL policy,⁶ Pro-Seal proceeds to undertake an elaborate process of re-defining "advertisement" in a way that allows Pro-Seal to conclude that an "advertisement" can consist of the verbal statements of a door-to-door salesperson, the label on a product, or, indeed, any verbal statement that "is delivered to any part of the marketplace," even to "one company." (See Pro-Seal's Supp Brf, pp 10-16).⁷ Not only do these examples of "advertisements" disregard the definition of that term included in the CGL policy, they reveal

⁶ Pro-Seal purports to quote the definition of "advertisement" from the CGL policy on page 10 of its supplemental brief, but does so erroneously. Pro-Seal omits the word "a" at the beginning of the definition, which, as explained in Citizens' application, is a critical word in the definition. The ordinary meaning of the phrase "a notice" is distinctly different than the ordinary meaning of the unmodified noun "notice," particularly when the phrase is followed by "that is published or broadcast." (See Citizens' Application, pp 23-24).

⁷ Pro-Seal takes several missteps in order to reach this erroneous conclusion in addition to misquoting the definition (See fn 6). It relies on questionable definitions of words used within the definition of "advertisement," i.e., "publish," "notice," and "broadcast" that are outdated. See *Hameid v Nat Fire Ins of Hartford*, 31 Cal 4th 16, 27; 1 Cal Rptr 3d 401 (2003), in which the court recognized that the insured was attempting to rely on an outdated definition of "advertising." It then proceeds to ignore those dictionary definitions and to re-define even those words. It also fails to read the words within the policy's definition of "advertisement" in context.

that Pro-Seal's attempted definition would have the effect of giving that term no distinctive meaning whatsoever. If, as Pro-Seal suggests, any statement that is delivered to any part of the marketplace, including any one company, constitutes an "advertisement" (Id., p 13), then literally every statement other than a confidential internal communication within a company is an "advertisement."

Pro-Seal's attempt to re-define "advertisement," not surprisingly, is devoid of a citation to a single authority from any jurisdiction to support it. In fact, a number of fairly recent decisions have correctly recognized that an underlying complaint does not allege "advertising" or an "advertisement" under circumstances that are either similar to the instant case or closer to "advertising" than anything alleged by Flowserve. In *Rombe Corp v Allied Ins Co*, 128 Cal App 4th 482; 27 Cal Rptr 3d 99 (2005), the court recognized that the term "advertisement," which was given the same definition in the insurance policy at issue in that case, should not be interpreted to include activity such as an attempted solicitation of customers. The court in that case explained:

Under the policy's definition, "advertisements" are notices "published or broadcast" either to the general public or specific market segments. Any plain reading of the words "published" and "broadcast" include [sic] the notion of a relatively large and disparate audience. [FN: Webster's Third New International Dictionary provides the following definitions of "publish": "to call to the attention of the public: ADVERTISE," "to place before the public (as through a mass medium): DISSEMINATE." "Broadcast" is defined as follows: "1: cast or scattered in all directions <seed [broadcast] from the hand in sowing>: widely diffused 2: made public by means of radio or television (<the use of [broadcast] appeals to motorists to keep off the roads>."'] As we interpret the AMCO policy, the reference to "specific market segments," is only a means of relieving an insured of the burden of showing that its advertising was directed to the general public, as opposed to some defined market, such as medical professionals, racing car enthusiasts, or horse breeders. The term "specific market segments" does not relieve an insured of the burden of demonstrating that it was engaged in relatively wide dissemination of its advertisements even if the distribution was focused on recipients with particular characteristics or interests.

We reject any broader interpretation of the AMCO policy for many of the reasons the court in *Hameid*⁸ discussed. An interpretation of the term “specific market segments” that is flexible enough to include guests at a meal hosted by an insured is flexible enough to include any kind of business communication.

Id. at 492.

In *PC Woo, Inc v The Tokio Marine & Fire Ins Co*, 2005 WL 2471032 (CA 9, 2005), the Court held that the mere display of products in a showroom did not constitute “advertising” because it was neither widespread nor directed to the public at large. In *Zurich Ins Co v Amcor Sun Clips North America*, 241 F3d 605 (CA7, 2001), the Court held that the mere sale of a product to a customer or person-to-person persuasion did not constitute “advertising.”

In *Western States Ins Co v Wisconsin Wholesale Tire, Inc*, 184 F3d 699 (CA7, 1998), the Court eloquently reasoned:

Wisconsin Tire wants us to treat “advertising” as equivalent to “marketing.” Then the work of a salesman in calling up customers is “advertising,” an unnatural use of that word, and any effort to sell that involves one of the four listed “offenses” is covered. But why is this a sensible reading of the policy? Wisconsin reads ambiguities favorably to the insured, but it does not torture ordinary words until they confess to ambiguity. Deconstruction is not part of Wisconsin’s approach to insurance contracts. MITA’s complaint does not allege that Wisconsin Tire engaged in any advertising. Perhaps Wisconsin Tire did some advertising, if only in the Yellow Pages, but the “advertising injury” coverage applies only to “injury arising out” the advertising, and there is a disconnect between that kind of advertising and the tort (the theft of trade secrets).

⁸ In *Hameid, supra*, the California Supreme Court held that the undefined term “advertising” as used in other CGL policies means “widespread promotional activities usually directed to the public at large.” *Id.* at 24. The court cited decisions from several jurisdictions, including Vermont, Maryland, Virginia, Massachusetts, Missouri, Illinois and Kansas that also defined “advertising” as widespread promotional activity directed to the public at large. *Id.* at 26, (citations omitted). The court in *Hameid* applied this definition to hold that telephone calls and mailers sent to specific customers advising them of a new location and lower prices constitute “solicitation,” not “advertising.” *Id.* at 29-30.

Id. at 702. Numerous other decisions cited in Citizens’ reply brief are in accord. See Citizens’ reply, pp 8-9.

In addition to essentially rewriting the definition of the term “advertisement,” Pro-Seal rewrites Flowserve’s complaint. For example, Pro-Seal argues that mechanical seals that had been repaired and rebuilt by Pro-Seal “were on display sitting on a shelf in a staging area at the Roteq distribution center . . . ,” and that Flowserve and Pro-Seal both maintained business locations in the same building as Roteq in part “to maintain access to the customers who frequent that center.” (Pro-Seal’s Supp Brf, pp 4-5). Pro-Seal explains that this was a place where company representatives and customers were invited, welcomed and expected. *Id.* at p 5. Pro-Seal elaborates further: “Indeed, it was hoped and planned by Pro-Seal that knowledge of their services would become even more widely known through use of a prominent red label displayed on product packaging.” *Id.* at pp 5-6. According to Pro-Seal, Pro-Seal’s use of a prominent red label on its packages, and placement of those packages at Roteq where passersby would hopefully see them “is a distribution and advertising system.” *Id.* at 6.⁹

There is nothing in the Flowserve complaint to support any of this speculation. The only parts of Flowserve’s complaint to which Pro-Seal points are subparagraphs 22(d) and 22(e). Neither of these subparagraphs provides the slightest support for the hypothesized scenario presented by Pro-Seal. To the contrary, both subparagraphs allege that Pro-Seal shipped a

⁹ These are by no means the only instances in which Pro-Seal describes “facts” that are neither alleged in nor reasonably inferable from the allegations of Flowserve’s complaint. Essentially the entire recitation of “facts” on pages 4-6 of Pro-Seal’s supplemental brief falls into this category, as do a number of other statements. It should also be noted that the only support Pro-Seal cites for any of these “facts” supposedly behind the complaint is its motion for summary disposition. The affidavit of Bruce McCartney mentioned on page 5 of Pro-Seal’s supplemental brief states only that the statements made in Pro-Seal’s motion for summary disposition and brief are true to the best of his knowledge, information and belief.

counterfeit “BXBW-4500” seal to a process industry customer, and that the seal was intercepted by a Flowserve mechanic. There is simply nothing in either of these subparagraphs—or anywhere else in Flowserve’s complaint—to suggest that Pro-Seal either did or even intended to place its products on display at a location that would be frequented by customers. There is nothing in Flowserve’s complaint to suggest, as Pro-Seal argues, “that Roteq’s place of business is a place where company representatives and customers are invited, welcomed and expected.” (Pro-Seal’s Supp Brf, p 5).¹⁰ Nor is there anything in Flowserve’s complaint that supports the statement that “it was hoped and planned by Pro-Seal that knowledge of their services would become even more widely known through use of a prominent red label displayed on product packaging.” (Pro-Seal’s Supp Brf, pp 5-6).

Indeed, the absence of any allegations in Flowserve’s complaint to support these hypothesized facts demonstrates unequivocally that Flowserve’s complaint does *not* seek damages based on them. In other words, even if all of Pro-Seal’s hypothesized “facts” are true, Flowserve’s complaint is quite clearly not based on them. By way of analogy, the CGL policy defines personal and advertising injury also to include “Oral or written publication of material that slanders or libels a person or organization” It is, of course, “possible” that Pro-Seal has slandered or libeled Flowserve at some point. But because there is no reference to such conduct in Flowserve’s complaint, that possibility does not require Citizens to defend Pro-Seal. The same result obtains here: Pro-Seal’s articulation of “facts” that supposedly existed, and which supposedly establish an advertisement, sheds no light on whether coverage was triggered by Flowserve’s complaint because the theories in that complaint are not based in any way on them.

¹⁰ Even Pro-Seal’s characterization of Roteq as a “distribution center” (Pro-Seal’s Supp Brf, p 4) is contrary to Flowserve’s complaint, which alleges that Roteq is “a pump repair vendor.” (Flowserve’s complaint, ¶ 22(d)).

Stripped of its improper redrafting of the Citizens policy and the Flowserve complaint, Pro-Seal's argument boils down to the proposition that the mere use of a label or a package that simply identifies the accompanying product is itself an "advertisement." To agree with that argument is to ignore not only the definition of "advertisement" but also the plain meaning of advertising generally. A television commercial promoting a product, a billboard, a radio promotion; these are "advertisements." Neither a box, which is necessary to package a product, nor a label, which is necessary to identify its contents, is an "advertisement." Virtually all products are packaged and labeled. If mere packaging or labeling constituted a means to claim advertising, the primary element for "advertising injury," namely "advertising," would be effectively discarded.

Because Flowserve's complaint does not allege a Pro-Seal "advertisement" as that term is defined in the Citizens CGL policy, it does not allege a "personal and advertising injury," and Citizens does not owe a duty to defend.

4. Flowserve's complaint does not allege trade dress infringement or use of a Flowserve advertising idea *in* a Pro-Seal "advertisement."

Possibly the most significant aspect of Pro-Seal's elaborate hypothesis about the supposed "real facts" giving rise to Flowserve's complaint is that it is ultimately a road to nowhere in terms of establishing coverage under the CGL policy. In addition to the deficiencies discussed above, Pro-Seal never answers this critical question: What Flowserve trade dress is alleged to have been infringed, or what Flowserve advertising idea is alleged to have been used, *in* a Pro-Seal advertisement? Pro-Seal goes to great lengths to explain how Pro-Seal was actually using a prominent red label on its products and attempting to have those products displayed in a location where they would be seen by potential customers. Even if all of this were true (and had been alleged in Flowserve's complaint), coverage still is not triggered because

there is no suggestion that Pro-Seal infringed Flowserve's trade dress or used a Flowserve advertising idea *in* a Pro-Seal advertisement. Pro-Seal does not even suggest that a Flowserve trade dress or advertising idea was included within the supposed prominent red label used by Pro-Seal. Likewise, the mere supposed placement of a Pro-Seal product in a Flowserve box – not a Pro-Seal box made to look like a Flowserve box, but an actual box of Flowserve's – simply does not constitute infringement of Flowserve's trade dress or use of Flowserve's advertising idea in a Pro-Seal advertisement.¹¹

Consequently, even taking all of the arguments in Pro-Seal's supplemental brief on their face, Pro-Seal nonetheless fails to establish coverage under the CGL policy.¹²

C. Citizens does not owe a duty to defend because Flowserve's complaint seeks only damages that are excluded.

Pro-Seal's argument regarding the exclusion for personal and advertising injury "[c]aused by or at the direction of the insured with knowledge that the act would violate the rights of another and would inflict 'personal and advertising injury,'" misconstrues the scope of Citizens' duty to defend. Citizens' duty to defend derives solely from one contractual provision, which states:

¹¹ Pro-Seal analogizes the present circumstances to the use of "prominent red signs on . . . Black & Decker boxes announcing that Pro-Seal had serviced or rebuilt that product." (Supplemental Brief, p 6). Even in that analogy there is no hint of the use of Black & Decker's trade dress or advertising idea *in* a Pro-Seal advertisement.

¹² Numerous cases have confirmed the requirement of a causal connection in the context of alleged advertising injury. See, e.g., *Advance Watch Co, Ltd v Kemper Nat'l Ins Co*, 99 F3d 795 (CA 6, 1996) (applying Michigan law to hold that merely displaying trade dress-infringing product in an advertisement does not establish causal connection; the advertising activity must cause the injury); *Diversified Investments Corp v Regent Ins Co*, 226 Wis 2d 563, 596 NW2d 502 (1999) (**Exhibit 2**) (finding *Advance Watch* persuasive, and holding that the underlying action did not stem from the insured's advertising of infringing products, but from the design of the products itself). See also additional cases, including decisions from the Michigan Court of Appeals, cited and discussed in Citizens' application, pp 27-29.

We will pay those sums that the insured becomes legally obligated to pay as damages because of “personal and advertising injury” to which this insurance applies. We will have the right and duty to defend the insured against any “suit” seeking those damages.

(Citizens CGL policy, filed as Exhibit C to its application for leave to appeal, 6th page).

Flowserve’s complaint alleges unequivocally, and unambiguously, that Pro-Seal intentionally and knowingly infringed its trademarks. It seeks damages based on that activity. It does not allege, or seek damages for, any negligent or unintentional trademark infringement. Consequently, if the allegations of trademark infringement in Flowserve’s complaint are held to constitute allegations of “[p]ersonal and advertising injury” under the Citizens CGL policy, they are allegations that fall entirely within the exclusion for “[p]ersonal and advertising injury’ . . . [c]aused by or at the direction of the insured with knowledge that the act would violate the rights of another and would inflict ‘personal and advertising injury’.”

Pro-Seal’s supplemental brief does not address the on-point cases cited in Citizens’ application for this proposition—despite the fact that Citizens pointed out in its reply brief that those cases were not addressed in Pro-Seal’s brief in opposition to the application for leave to appeal. Pro-Seal cites *Cosser v One Beacon Ins Group*, 15 AD3d 871 (NY S Ct App Div, 2005). But the court in that case was applying New York law to the issue of whether an insurer owes a duty to defend. The court also recognized that at least some of the causes of action in the underlying complaint arguably arose from covered events. *Id.* at 874. Even if *Cosser* were considered on point, Citizens submits it was wrongly decided, and that the cases cited in

Citizens' application that construed the "with knowledge" exclusion under facts that are not materially distinguishable from the instant case, are correct.¹³

¹³ In the final argument section of its supplemental brief, Pro-Seal suggests that there are "5 Federal Circuit Court decisions and numerous District Court decisions" cited by it that support its position of coverage, but does not identify them (Pro-Seal's Supp Brf, p 23). As explained in Citizens' application, there is not a single decision from any jurisdiction involving facts comparable to those at bar that supports a finding of coverage under the language of the Citizens CGL policy form—and many that support Citizens' position that coverage is lacking. Pro-Seal also argues that it is reasonable to infer that trademark claims are covered under the Citizens CGL policy (which utilizes the 1998 ISO form) by virtue of the fact that "there was a specific exclusion in most policies which excluded coverage for trademark claims," which "was removed in 1986." (Pro-Seal's Supp Brf, p 22). However, as the very case on which Pro-Seal relies for this proposition explains, until 1986 the standard ISO form included "unfair competition" as a covered class of advertising injuries. *Industrial Molding v Mfrs Mut Ins Co*, 17 F Supp 2d 633, 638 (ND Tex, 1998), vacated at 22 F Supp 2d 569. In 1986, the ISO revised the standard form to eliminate unfair competition and replace it with "misappropriation of advertising ideas and style of doing business." *Id.* The removal of the exclusion for trademark infringement was presumably predicated on the assumption that, while trademark infringement falls within "unfair competition," it does not fall within "misappropriation of advertising ideas and style of doing business." In any event, as Citizens pointed out in its application, in 1998 the ISO revised the form to provide coverage specifically for trade dress—not trademark—infringement in an insured's "advertisement." If the evolution of the ISO forms shows anything, it is that coverage was never intended for trademark infringement.

CONCLUSION

For the reasons set forth herein, in Citizens' application for leave to appeal, and in Citizens' reply brief in support of its application, Citizens requests that this Court peremptorily reverse the Court of Appeals' decisions, or grant its application. Citizens further requests any and all other relief to which it is entitled.

Respectfully submitted,

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